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No. 239

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IN THE
Supreme Court of the United States
OCTOBER, 1946, TERM

JOSEPH MELTZER and BERTHA MELTZER,
Petitioners,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE 2ND CIRCUIT AND BRIEF IN
SUPPORT THEREOF**

✓
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JOSEPH MELTZER and BERTHA MELTZER,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF
APPEALS FOR THE 2ND CIRCUIT**

JOSEPH MELTZER and BERTHA MELTZER respectfully submit this petition and pray that a writ of *certiorari* issue to review the decision and mandate of the United States Circuit Court of Appeals for the 2nd Circuit which affirmed an order of the Tax Court of the United States which had "ordered and decided that there is a deficiency in the income tax for the calendar year 1941 in the amount of \$4,571.65".

Opinions Below

The memorandum, findings of fact and opinion of the Tax Court of the United States are dated June 20, 1945. A copy thereof is annexed and marked Appendix A.

The majority opinion of the United States Circuit Court of Appeals for the 2nd Circuit written by Circuit Judge Phillips is dated April 15, 1946. A copy thereof is annexed and marked Appendix B.

The dissenting opinion of Circuit Judge Learned Hand of the United States Circuit Court of Appeals for the 2nd Circuit is annexed and marked Appendix C.

Summary Statement of the Matters Involved

This proceeding concerns a deficiency assessment against the petitioners for income taxes for the calendar year 1941.

The letter of the respondent claiming such deficiency is dated February 25, 1944. From such proposed adjustment of petitioners' tax liability, petitioners appealed to the Tax Court of the United States by petition verified April 10, 1944.

The Tax Court of the United States decided the issues in favor of the respondent. The petitioners appealed from such determination to the United States Circuit Court of Appeals, 2nd Circuit, by petition verified August 29, 1945.

The Circuit Court of Appeals affirmed the judgment of the Tax Court, Circuit Judge Learned Hand Dissenting.

Jurisdiction

The mandate of the Circuit Court of Appeals for the 2nd Circuit was entered on April 15, 1946. The jurisdiction of the Supreme Court of the United States is founded on Section 347-a of the United States Judicial Code.

The Facts Herein

The following are the facts of this case as found by the Tax Court:

The petitioners, husband and wife, are residents of New York City. They filed a joint income tax return for the calendar year 1941 with the Collector of Internal Revenue for the 3rd District of New York. Joseph Meltzer will hereinafter be referred to as the petitioner.

In the return petitioner claimed a deduction from gross income of \$13,000 as a bad debt. This deduction was disallowed by the respondent. Petitioner thereafter claimed that the total amount of bad debt deductions to which he is entitled is \$14,250.

The petitioner was a civil engineer with an office at 10 East 40th St., New York City. He was associated in business with Herman M. Braloff.

In 1929 Victor Mayper, a friend of petitioner, who was an architect and engineer, engaged in the designing and supervision of the construction of speculative industrial buildings and apartment houses, and who had had considerable income for a number of years from the practice of his profession, approached the petitioner for a loan of \$13,000, and offered as security a mortgage upon his residence in Douglastown, Long Island. Mayper had built this residence in 1928 at a cost of approximately \$50,000. There was at the time a first mortgage on the property of \$20,000 and a second mortgage of \$12,500, though these mortgages by 1929 may have been reduced by the amount of a few hundred dollars. The petitioner did not have the \$13,000 to lend him but thought his associate in business, Braloff might be willing to make the loan. Braloff had the money and made the loan. As security Mayper gave a personal bond to Braloff in the amount of \$13,000, a note for the same amount bearing interest, and a third mortgage upon his residence in Douglastown. The principal security of Braloff, was however, the petitioner's collateral bond in the sum of \$13,000 guaranteeing the payment of the note and mortgage.

When the time came for the payment of interest upon the note Mayper was without funds to make any payment thereon. Braloff then requested the petitioner to make good on his bond. After some negotiations between Braloff and the petitioner, Braloff accepted \$10,000 in

cash from the petitioner in satisfaction of his bond. The petitioner then became subrogated to all of Braloff's rights against Mayper. The petitioner then looked to Mayper for the payment of interest upon his note. By reason of the financial crash of 1929 and the subsequent decline in building operations, Mayper was not able to make any payment on the note. He did, however, give several notes to the petitioner for the amount of the interest which was due but unpaid.

Through his friendship for Mayper and for the purposes of tiding him over the financial depression the petitioner made additional advances to Mayper as follows:

2 months prior to August 7, 1930.....	\$ 250.
August 7, 1930.	1,500.
June 17, 1931	500.
March 16, 1932	1,000.
November 25, 1932	1,000.
Total	<u>\$4,250.</u>

Mayper's financial condition continuously deteriorated. He was not able to make any payments to the petitioner upon his indebtedness. In 1935 the holder of the first mortgage on Mayper's residence at Douglstown foreclosed, and the property was sold for approximately \$24,000, which was only sufficient to pay off the first mortgage and arrears in taxes. Neither the holder of the second mortgage nor the petitioner obtained deficiency judgments against Mayper.

From 1935, after the foreclosure, until 1941, the financial condition of Mayper did not improve. After 1935 Mayper had no real property and no personal property except wearing apparel of less than \$300 in value and office furniture of \$50 in value. He had no credit whatever except a limited amount from a blueprinter. From 1935 on his liabilities, including indebtedness to the petitioner, were approximately \$28,000 in excess of assets.

In June, 1937, Mayper was put through supplementary proceedings in respect to a debt of \$1,282.70. This debt was compromised by the payment of \$310 by Mayper with money which he borrowed from another party. He made this compromise settlement in order to avoid bankruptcy proceedings.

In 1940 the affairs of Mayper were poor as described by Mayper and "sad" as related by him to Joseph Meltzer.

The petitioner made many demands upon Mayper for at least installment payments upon his indebtedness to him. Mayper frankly stated that he was not in a position to make any payment until business improved.

In 1941 the petitioner made a final demand upon Mayper for the payment of his money but Mayper stated that his financial condition had not improved—that he was in no position to make payment. The petitioner threatened to obtain a judgment against Mayper for the payment of his indebtedness and Mayper told him that if he did it would simply force him into bankruptcy. He then was requested to submit to an examination by his attorney as to his financial condition. He readily submitted to such examination on December 18, 1941, and stated that besides having no assets of any material value he owed others besides petitioner approximately \$7,500 and that by reason of priorities resulting from the war situation he did not expect that his financial condition would improve to enable him ever to make any payment upon his indebtedness to the petitioner.

Questions Presented

1. Does Section 23K (d) of the Internal Revenue Code which makes Section 23K (1) of the Revenue Act of 1942 retroactive to taxable years after December 31, 1938 mean that the deduction of debts which became worthless before

December 31, 1938 are to be allowed or disallowed under the old law or the new law?

2. Was it necessary that the Tax Court make definite findings of fact stating the year in which the debt became actually worthless and the year in which Meltzer ascertained worthlessness?

3. If the first question is answered in the affirmative,—that if the debt became worthless prior to December 31, 1938, the taxpayer is entitled to a deduction in the year in which he ascertained the debt to be worthless—does the word “ascertain” mean ascertainment by the creditor in his judgment, or does it mean that the creditor is required to determine worthlessness when he or a reasonable man ought to have done so?

4. Is Section 23K (d) of the Revenue Act of 1942 which makes Section 23K (1) retroactive to taxable years after December 31, 1938 unconstitutional because it is retroactive for longer than a reasonable period of time in view of the special circumstances surrounding the enactment of the amendments?

Statutes Involved

At the time petitioner filed his return for the year 1941, bad debt deductions were controlled by the Internal Revenue Code, Section 23 (k) which provided as follows:

“Bad Debts.—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.”

Subsequently and on October 21st, 1942, Congress adopted the Revenue Act of 1942, in which the rule for the deduction of bad debts was changed as follows:

Section 124; Revenue Act of 1942:

Section 23 (k) (1)

"General rule.—Debts which become worthless within the taxable year; or (in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part which becomes worthless within the taxable year, as a deduction. This paragraph shall not apply in the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection. This paragraph shall not apply in the case of a taxpayer other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection."

Section 23 (k) (4)

"Non-business debts—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term 'non-business debt' means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business."

Section 23 (k) (d)

"Effective Date of Amendments—The amendments made by this section adding the last sentence of sec-

tion 23 (k) (1) and adding section 23 (k) (4) shall be effective only with respect to taxable years beginning after December 31, 1942, the amendment inserting section 23 (k) (5) and amendments related thereto shall be applicable only with respect to taxable years beginning after December 31, 1941; and the other amendments made by this section shall be effective with respect to taxable years beginning after December 31, 1938."

Specifications of Errors to be Urged

The Circuit Court of Appeals erred:

1. In applying to the facts found by the Tax Court Section 23 (k) (1) of the Revenue Act of 1942 instead of Section 23 (k) as it existed prior to such amendment.
2. In failing to rule that the Tax Court erred in omitting to make findings of fact as to the year in which the debt actually became worthless and the year in which the taxpayer ascertained it to be worthless.
3. In holding that Congress had the power to make the 1942 amendment retroactive so as to apply to the taxable year 1941, and in holding such provisions constitutional.

Reasons relied on for the Allowance of this Writ

The reasons certiorari should be granted in this case are as follows:

1. There is a Federal question of importance involving income tax laws not yet determined. It is necessary to settle the meaning of the retroactive clause of the 1942 amendments regarding deductions for bad debts. Shall the Treasury Department and taxpayers, in the future, be guided by the construction placed upon the statute by the

majority or minority opinion of the Circuit Court of Appeals in this case? (The case of *Cittadine v. Commissioner*, 139 Fed. (2d) 29 cited in the majority opinion is purely dicta as is shown in the accompanying brief.)

The construction given in the majority opinion of the Circuit Court of Appeals in this case offers no relief to taxpayers as was intended by Congress, but made their lot more burdensome. The House Ways and Means Committee report (#2333—77th Congress 2nd Session P. 44) shows the intention of Congress. The report states as follows:

“Under the existing law, the taxpayer may be whipsawed out of a deduction for a bad debt because of the uncertainty as to the time at which the debt becomes worthless. Later evidence often discloses that present decisions as to the year in which a debt becomes worthless are erroneous. For example, the taxpayer concludes that a debt has become bad and takes the deduction in that year, only to discover by later evidence that the debt actually became worthless 3 years previously. The statute of limitations having run on such previous year, this deduction is lost forever to the taxpayer. Conversely, where the debt actually became worthless in a year later than the year chosen by the taxpayer, the 3-year statute of limitations may operate against the Government.

To relieve this inequitable situation the bill replaces the present 3-year statute of limitations in such cases with a 7-year statute, giving a considerably greater flexibility to the allowance of bad debt deductions in the proper year.”

2. If the construction contended for by Judge Hand is the correct one it is then necessary to settle the conflict between Circuits as to the meaning and application of the word “ascertainment.” The rule in the 2nd Circuit

was last expressed in *Mayer Tank Manufacturing Co. v. Commissioner*, 126 Fed. (2) 588, 591, that the taxpayers should have the deduction in the year in which he in fact ascertained the debt to be worthless. This is commonly called the "subjective test". Other Circuits have applied the "objective test" and hold that a debt is ascertained to be worthless when the creditor or a reasonable man ought to have determined the debt to be so. This is the rule in the 3rd Circuit, *Reading v. Commissioner*, 132 Fed. (2d) 306, 309.

3. A tax statute may be declared unconstitutional if it is retroactive for an unreasonable length of time. In each case it is necessary to consider the nature of the tax and the circumstances surrounding the enactment of the law. *Welsh v. Henry*, 305 U. S. 134. The circumstances under which the above mentioned 1942 amendments were adopted differ, so far as we have been able to find, from the facts in all other reported decisions involving retroactive tax laws in that the law now in issue was intended to relieve taxpayers from the inequities of a prior law. It is an anomalous tax law in that it was intended to operate retroactively for the relief of taxpayers.

The Importance of a Review of the Questions Herein Involved

The decision of this case is one of general applicability. Judge Hand's forceful argument that the 1942 amendments were not intended to apply to a debt which became worthless prior to December 31, 1938 was not answered by the majority. They pointed to no reason why his construction is untenable. It is important for the Government and taxpayers to know whether they are to be guided by the opinion of the majority or by Judge Hand's dissent. This case presents the question of law squarely without any involvement in questions of fact.

Conclusion

For the reasons stated it is respectfully submitted that the writ of certiorari prayed for herein should be granted to the end that the mandate of the United States Circuit Court of Appeals, 2nd Circuit, herein may be reviewed and reversed, and for such other and further relief as may be just and proper.

June 27th, 1946.

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Appendix A.**MEMORANDUM FINDINGS OF FACT AND OPINION
THE TAX COURT OF THE UNITED STATES**

[SAME TITLE]

MORTIMER DEGROOT, Esq., for the petitioners.

WILLIAM F. EVANS, Esq., for the respondent.

SMITH, Judge: This proceeding is for the redetermination of a deficiency in income tax for the calendar year 1941 in the amount of \$4,571.65. The petitioners allege that the respondent erred in the determination of the deficiency by disallowing the deduction from gross income of \$14,250 bad debts.

FINDINGS OF FACT.

The petitioners, husband and wife, are residents of New York City. They filed a joint income tax return for the calendar year 1941 with the collector of internal revenue for the third district of New York. Joseph Meltzer will hereinafter be referred to as the petitioner.

In the joint income tax return for 1941 the petitioner claimed the deduction from gross income of \$13,000 as a bad debt. This deduction was disallowed by the respondent in the determination of the deficiency. Petitioner now alleges that the total amount of bad debts to which he is entitled as a deduction is in the amount of \$14,250.

The petitioner is a civil engineer with an office at 10 East 40th St., New York City. He is associated in business with Herman M. Braloff.

Appendix A.

In 1929 Victor Mayer, a friend of petitioner, who was engaged in the designing and supervision of the construction of speculative industrial buildings and apartment houses, and who had had considerable income for a number of years from the practice of his profession, approached the petitioner for a loan of \$13,000. He stated that he would give a mortgage upon his residence in Douglastown, Long Island, as security for the loan. Mayer had built this residence in 1928 at a cost of approximately \$50,000. There was at the time a first mortgage on the property of \$20,000 and a second mortgage of \$12,500, though these mortgages by 1929 may have been curtailed by the amount of a few hundred dollars. The petitioner did not have the \$13,000 to loan him but thought his associate in business, Braloff might be willing to make the loan. Braloff had the money and made the loan. As security for the loan Mayer gave a personal bond to Braloff in the amount of \$13,000, a note for the same amount bearing interest, and a third mortgage upon his residence in Douglastown. The principal security of Braloff was, however, the petitioner's bond in the sum of \$13,000 guaranteeing the payment of the note and mortgage pursuant to its terms.

When the time came for the payment of interest upon the note Mayer was without funds to make any payment thereon. Braloff then requested the petitioner to make good on his bond. After some negotiations between Braloff and the petitioner, Braloff accepted \$10,000 in cash from the petitioner in satisfaction of his bond. The petitioner then became subrogated to all of Braloff's rights in respect of the loan which he had made to Mayer. The petitioner then looked to Mayer for the payment of interest upon his note. By reason of the financial crash of 1929 and the subsequent decline in building operations, Mayer was not able to make any payment

Appendix A.

on the note. He did, however, give several notes to the petitioner for the amount of the interest which was due but unpaid.

Through his friendship for Mayper and for the purpose of tiding him over the financial depression the petitioner made additional advances to Mayper as follows:

2 months prior to August 7, 1930	\$ 250
August 7, 1930	1,500
June 17, 1931	500
March 16, 1932	1,000
November 25, 1932	1,000

Mayper's financial condition continuously deteriorated. He was not able to make any payments to the petitioner upon his indebtedness to him. In 1935 the holder of the first mortgage on Mayper's residence at Douglaston foreclosed the first mortgage on the property, which was sold at a price of approximately \$24,000, which was only sufficient to pay off the first mortgage and arrears in taxes. Neither the holder of the second mortgage nor the petitioner obtained deficiency judgments against Mayper.

From 1935, after the foreclosure, until 1941, the financial condition of Mayper did not improve. After 1935 Mayper had no real property and no personal property except wearing apparel of less than \$300 in value and office furniture of \$50 in value. He had no credit whatever except a limited amount from a blueprinter. From 1935 on his liabilities, including indebtedness to the petitioner, were approximately \$28,000 in excess of assets.

In June, 1937, Mayper was put through supplementary proceedings in respect of a debt of \$1,282.70. This debt was compromised by the payment of \$310 by Mayper with

Appendix A.

money which he borrowed from another party. He made this compromise settlement in order to avoid bankruptcy proceedings.

In 1940 the affairs of Mayper were poor as described by Mayper and "sad" as related by him to Joseph Meltzer.

The petitioner made many demands upon Mayper for at least installment payments upon his indebtedness to him. Mayper frankly stated that he was not in a position to make any payment until business improved.

In 1941 the petitioner made a final demand upon Mayper for the payment of his money but Mayper stated that his financial condition had not improved—that he was in no position to make payment. The petitioner threatened to obtain a judgment against Mayper for the payment of his indebtedness and Mayper told him that if he did it would simply force him into bankruptcy. He then was requested to submit to an examination by his attorney as to his financial condition. He readily submitted to such examination on December 18, 1941, and stated that besides having no assets of any material value he owed others besides petitioner approximately \$7,500 and that by reason of priorities resulting from the war situation he did not expect that his financial condition would improve to enable him ever to make any payment upon his indebtedness to the petitioner. Upon the basis of these facts the petitioner claimed the deduction from his gross income for 1941 of the \$13,000 which was disallowed by the respondent in the determination of the deficiency.

The debt owed by Victor Mayper to the petitioner in the amount of \$14,500 became worthless prior to 1941.

Appendix A.

OPINION.

The only question presented by this proceeding is whether the debt owed by Victor Mayper to the petitioner in the amount of \$14,250 became worthless in 1941.

Section 23 (k) of the Internal Revenue Code, as amended by section 124 (a) of the Revenue Act of 1942, permits the deduction from gross income of "Debts which become worthless within the taxable year." Prior to that time that section of the Code permitted the deduction from gross income of "Debts ascertained to be worthless and charged off within the taxable year." The amendment was made effective "with respect to taxable years beginning after December 31, 1938." See section 124 (d) of the Revenue Act of 1942.

In *Harris v. Commissioner* (C. C. A., 2nd Cir.), 140 Fed. (2d) 809, the court had before it the question as to whether a debt claimed to have been ascertained to be worthless and charged off in 1936 was a legal deduction from the gross income of that year. In its opinion the court said:

* * * There is no doubt, nor is any claim to the contrary here made that as the law then stood the petitioner was bound to make the charge-off in the year in which he first ascertained the debt to be worthless * * * In our view the "subjective test" is the right one, and the proper year to make the charge-off is that in which the taxpayer actually makes the determination of worthlessness. *Rosenthal v. Helvering* (2 Cir.) 124 Fed. (2d) 474; *Curry v. Commissioner* (2 Cir.) 117 Fed. (2d) 307. * * *

We think it quite clear that the question before us in this proceeding is not when the debt of Mayper to the

Appendix A.

petitioner was ascertained by the petitioner to be worthless and charged off, but rather the objective test as to when it actually became worthless.

The petitioner contends that it actually became worthless in 1941; that up until then he had hopes of ultimately collecting his debt from Mayper, because Mayper had been successful in his profession prior to 1930 and because there was a probability that he would again regain financial ability to pay his debts. He also argues that the entrance of the United States into war with Germany and Japan in December, 1941, was an identifiable event which made the debt worthless in 1941.

We do not think that the petitioner's contention has a realistic basis. By 1935 Mayper had lost all his property and was indebted to others besides the petitioner. He appears never to have been able to make more than his living expenses after 1935. On cross examination Mayper testified as follows:

Q. Now, at the time in 1941 in which you made an affidavit or statement to counsel of petitioner, you say you are indebted to him in the sum of \$5,370 and then the further sum of \$13,000; and you had no means or income to pay that indebtedness or any part of it; that would be true ever since 1935, would it not?

A. Yes.

Q. You say, then, that you have no personal property or any interest therein, and that condition has been true since 1935, has it not?

A. Yes.

Q. You say you have no personal property other than wearing apparel of the value of less than \$300, and office furniture of the value of not exceeding \$50;

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I will ask you if that position has not obtained since 1935 with reference to your affairs?

A. I would say so, yes.

It seems to us that the evidence clearly shows that Mayer's debt to the petitioner became worthless long prior to 1941 and that there was no happening in 1941 which made the debt worthless in that year.

In our opinion the respondent properly denied the deduction of the claimed debt from the petitioner's gross income for 1941.

Decision will be entered for the respondent.

ENTER:

Entered June 20 1945

(Seal)

Appendix B.

**UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT**

No. 168—October Term, 1945.

(Argued March 7, 1946 Decided April 15, 1946.)

Docket No. 20052

JOSEPH MELTZER and BERTHA MELTZER,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Before:

L. HAND, SWAN and PHILLIPS,
Circuit Judges.

On Petition to Review the Decision of the Tax Court of
the United States.

HARRY J. STEIN, *for petitioners.*

S. DEE HANSON, Acting Asst. Atty. Gen. (SEW-
ALL KEY and HELEN R. CARLOSS, *Sp. Assts.*
to the Atty. Gen., were with him on the
brief) *for respondent.*

PHILLIPS, *Circuit Judge,* delivered the opinion of the
court.

This is a petition to review a decision of the Tax Court.

Appendix B.

Petitioners Joseph Meltzer¹ and Bertha Meltzer, husband and wife, filed a joint tax return for 1941, in which they claimed a deduction of \$13,000 as a bad debt.

Sec. 23 of the Revenue Act of 1942 provides:

“In computing net income there shall be allowed as deductions: * * *

“(k) (1) debts which become worthless within the taxable year.”

The amendment was approved October 21, 1942, and by its terms was retroactive so as to include the year 1941.

Mayper, the debtor, was a designer and a supervisor of construction of industrial buildings and apartment houses. In 1928, he built a residence at a cost of \$50,000. It was encumbered by a first mortgage of \$20,000 and a second mortgage of \$12,500. Mayper obtained a loan of \$13,000 from one Braloff. Mayper gave Braloff a personal bond and a note, bearing interest, each for the sum of \$13,000, and a third mortgage upon the house to secure the note and bond. Meltzer gave Braloff a collateral bond for \$13,000 to guarantee the loan. Mayper defaulted in the payment of interest, and Braloff made demand on Meltzer for payment of the indebtedness under the guarantee. After some negotiations, Braloff accepted \$10,000 from Meltzer, in satisfaction of his bond, and assigned Mayper's bond, note, and mortgage to Meltzer. By reason of the financial depression in 1929 and subsequent years, and the decline in building operations, Mayper was not able to make any payments on the note. He gave several notes to Meltzer for accrued interest. Through his friendship with Mayper, and for the purpose of tiding Mayper over the financial depression, Meltzer made advances to Mayper in the years 1930, 1931,

¹ Hereinafter referred to as Meltzer.

Appendix B.

and 1932, aggregating \$4,250. Mayper's financial condition deteriorated progressively. Meltzer made demands upon Mayper from time to time for payments on the indebtedness, without avail. In 1935, the first mortgagee foreclosed his mortgage. At the foreclosure sale, it sold for an amount sufficient only to pay the first mortgage indebtedness and arrears in taxes. Neither the holder of the second mortgage nor Meltzer obtained deficiency judgments against Mayper. From 1935 to 1941, Mayper's financial condition did not improve. By 1935, he was without property except wearing apparel and office furniture. From 1935 on, his liabilities were approximately \$28,000 in excess of his assets.

The Tax Court found that the debt did not become worthless in the taxable year 1941.

Petitioners contend that it was not until the advent of the war, and the virtual suspension of the construction of building of a nondefense nature, and the resulting inability of Mayper to obtain employment, that the debt became worthless.

A finding of fact made by the Tax Court, if supported by substantial evidence, is conclusive.² We are of the opinion that the facts, with respect to Mayper's financial condition from 1935 to 1940, fully warranted the Tax Court in finding that the debt did not become worthless in 1941.

Since deductions are a matter of legislative grace,³ we think there can be no doubt of the power of Congress to make the 1942 amendment retroactive so as to apply to the taxable year 1941.⁴

Affirmed.

² *Hekvering, Commissioner v. Kehoe*, 309 U. S. 277, 279.

³ *Antietam Hotel Corporation v. Commissioner*, 4 Cir., 123 F. 2d 274, 278.

⁴ *Cittadine v. Commissioner*, 4 Cir., 139 F. 2d 29, 31; *Milliken v. United States*, 283 U. S. 15, 21.

Appendix C.

L. HAND, *Circuit Judge* (dissenting):

I agree that we must accept the finding of the Tax Court that the debt did not become worthless in 1941; but that court did not find whether it became worthless before or after December 31, 1938. The amendment to § 23(k)(1) in 1942 was made retroactive to December 31, 1938—§ 23(k)-(d)—and that, I submit, meant that the deduction of debts becoming worthless before then was to be determined under the old law. If so, debts, although they had actually become worthless before December 31, 1938, were to be deducted in the year in which the creditor "ascertained" that they became worthless. We have ruled a number of times—last in *Mayer Tank Manufacturing Co. v. Commissioner*, 126 Fed. (2) 588, 591—that the year in which a debt is "ascertained" to be worthless is that in which the creditor in fact "ascertained" it to be so, and not that in which he ought to have done so, or which a reasonable man would have done so. Other circuits have held the contrary—e. g. *Reading Co. v. Commissioner*, 132 Fed. (2) 306, 309 (C. C. A. 3)—but I assume that we should follow our own precedents. The Tax Court made no finding whether the taxpayer first "ascertained" the debt to be worthless in 1941, although I believe that there was adequate basis for a finding that it was in that year. For the foregoing reasons I regard findings necessary upon the following questions: (1.) Did the debt become worthless before December 31, 1938? (2.) Did the taxpayer in fact "ascertain" before 1941 that it had become worthless?

I submit that this interpretation is the only one consistent with the purpose of the amendment, if, as I understand to have been the case, it was intended to relieve creditors. As the law was, they were in a difficult position, because they had to prove, not only that the debt had become worthless, but that the year in which they claimed

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the deduction was the first in which they had "ascertained" that it had become so; and the last in particular was often extremely troublesome. It is true that the present law imposes upon them the risk of learning when the debt does become worthless, but in that it does no more than in the case of other losses. My brothers are now deciding that, if a creditor failed to claim deduction for a debt which actually became worthless before 1939, he may never deduct it, although he was under no duty to "ascertain" its worthlessness in that year, the statute having assured him that he need not claim it until he in fact did "ascertain" it. The amendment therefore increased, instead of lightened, the burden of such taxpayers, and in effect took away their privilege altogether. True, creditors whose debts became worthless in 1939, 1940, 1941, were at their peril bound to claim the deduction for those years, and it might appear that they were as much shut out as those whose debts became worthless earlier; but this is untrue, for in 1942 such creditors still had time to claim a refund for those years (§ 169(a)(2) of the Act of 1942). To confine the retroactivity of the amendment to debts becoming worthless after 1938, is, therefore, I submit, not only consistent with the text, but with the demands of justice.

Finally, I think that the question is open to us upon this appeal. I should suppose that a question of law emerges with enough distinctness from any questions of fact in which it is enmeshed, to require an answer; and that that question was also one of general applicability. Indeed, it would seem that our jurisdiction must extend so far, if we are to have any whatever.

IN THE
Supreme Court of the United States

JOSEPH MELTZER and BERTHA MELTZER,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONERS' BRIEF

The Facts

The facts will be found on pages 2 to 5 of the petition.

Statutes Involved

The statutes involved are set forth on pages 6 and 7 of the petition. They may be tersely summarized as follows:

On October 21, 1942 Section 23 (k) (1) of the Internal Revenue Code was adopted. It provided that in computing net income there shall be allowed as deductions debts which became worthless within the taxable year.

Section 23 (k) (d) of the same Act provided that the said amendment shall be retroactive to taxable years beginning after December 31, 1938.

Prior to the said amendments Section 23 (k) of the Internal Revenue Code provided that there shall be allowed as deductions debts ascertained to be worthless and charged off within the taxable year.

Specifications of Errors

The Specifications of Errors are set forth on page 8 of the petition.

Argument

This appeal brings to the Supreme Court a case involving a question of income tax law of considerable importance which has not been previously decided, and one in which there has been a forceful dissenting opinion. The question is one of general application.

Should the Supreme Court decide that the law should be construed as contended by Judge Hand in his dissenting opinion, it will also be necessary to decide an issue on which there is a conflict between circuits—Shall the “subjective test” or the “objective test” be applied in deciding when the taxpayer ascertained a debt to be worthless?

To determine the intention of Congress, the history of the amendments is material. Prior to 1942 there was considerable confusion in income tax practice over the question of when a debt was ascertained to be worthless. Taxpayers and Internal Revenue Agents frequently disagreed and many injustices resulted. There was even a conflict of opinion in the Circuit Courts. The law in the 2nd Circuit is that a debt is ascertained to be worthless in the year in which the creditor in fact determined it to be so. (*Mayer Tank Co. v. Commissioner*, 126 Fed. (2) 588). In the 3rd Circuit it is held that a debt is ascer-

tained to be worthless in the year in which the taxpayer or a reasonable man ought to have determined it to be worthless (*Reading v. Commissioner*, 137 Fed. (2) 306).

In submitting the 1942 amendments the House Ways and Means Committee recognized the existing uncertainties and injustices. The intention of Congress is stated in their report (House of Representatives Report #2333, 77th Congress 2nd Session) at page 44 as follows:

"Under the existing law, the taxpayer may be whipsawed out of a deduction for a bad debt because of the uncertainty as to the time at which the debt becomes worthless. Later evidence often discloses that present decisions as to the year in which a debt becomes worthless are erroneous. For example, the taxpayer concludes that a debt has become bad and takes the deduction in that year, only to discover by later evidence that the debt actually became worthless 3 years previously. The statute of limitations having run on such previous year, this deduction is lost forever to the taxpayer. Conversely, where the debt actually became worthless in a year later than the year chosen by the taxpayer, the 3-year statute of limitations may operate against the Government.

To relieve this inequitable situation the bill replaces the present 3-year statute of limitations in such cases with a 7-year statute, giving a considerably greater flexibility to the allowance of bad debt deductions in the proper year."

The statute should therefore be construed with that expressed intention in mind. Judge Hand, in his dissenting opinion in this case, stated that in view of the intention of Congress the retroactivity of the amendments should not apply to debts which became worthless prior to December 31, 1938 and in such event the taxpayer should be permitted to take his deduction under the old law in the year in which he ascertained worthlessness.

The application of this construction requires findings of fact as to the year in which the debt actually became worthless and the year in which the taxpayer ascertained worthlessness.

The petitioners also claim that if Judge Hand's contention is not adopted by the Supreme Court, the retroactive provisions of the law should be declared unconstitutional. The rule for the determination of the constitutionality of retroactive tax laws is set forth in *Welsh v. Henry*, 305 U. S. 134 wherein the Court stated:

"In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it is said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation."

We do not cite any other decisions because the facts with respect to the 1942 amendments are anomalous and we could find no case in point. It cannot be contradicted that the 1942 amendments were intended to relieve taxpayers from the inequities of the prior law. If the new law, intended as a reform, has the effect of making the taxpayers' burden more oppressive than it was under the inequities of the old law, then we urge that under the doctrine of *Welsh v. Henry* (supra), its retroactive application is "so harsh and oppressive that it transgresses the constitutional limitation." The harshness of retroactivity in this case is that, it having been found that the debt did not become worthless in 1941, petitioners are also being deprived of the deduction on the basis of ascertainment.

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In the Circuit Court of Appeals the petitioners argued that upon the facts found by the Tax Court it should have concluded that the debt became worthless in 1941 and that it was also properly ascertained to be worthless in 1941. The three Judges of the Circuit Court, however, refused

to disturb the conclusions of the Tax Court. On this appeal the petitioners abandon their claim that upon the facts found the Tax Court should have reached a different conclusion. Petitioners did, however, urge in the Circuit Court that the Tax Court erred in applying to the facts Section 23 (k) (1) of the Revenue Act of 1942 instead of Section 23 (k) of the old law (Transcript, fol. 63). The question of law is squarely presented for decision here without any involvement in questions of fact.

The majority opinion cited in the case of *Cittadine v. Commissioner*, 139 Fed. (2) 29, 31. That case, however, is not binding as precedent. The Court distinctly stated that it was not necessary to rule on the constitutionality of the 1942 amendment because the taxpayer, upon the facts presented, was not entitled to the deduction under the old law or the new law.

Conclusion

For these reasons it is respectfully submitted that the writ of certiorari prayed for herein should be granted.

Respectfully submitted,

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